1 SUMMARY AND RECOMMENDATIONS

1.1 Recommendations

On the basis of the analysis, consultation and assessment undertaken in respect of the Modification Proposal P07 (the Modification) during the Assessment Procedure, and the resultant findings of this report, the Modification Group (P7MG) recommends that the BSC Panel (the Panel) should:

1. **Proceed to the Report Phase;**
2. **Recommend to the Authority that the Alternative Modification, permitting any grouping of Supplier BM Units in the same GSP Group to be within the same Trading Unit together with any number of CVA registered Licence Exemptable Generator BM units in the GSP Group, be approved and hence reject the original Modification;**
3. **Note that the implementation of this Alternative Modification potentially impacts the Transmission Network Use of System (TNUoS) Charging Methodology; and**
4. **Note that the P7MG recommends that the implementation date for this Alternative Modification should be the Settlement Day falling four weeks after approval of this Alternative Modification Proposal by the Authority.**

1.2 Background

Modification Proposal P07, raised on the 18th April 2001 by Powergen, proposed allowing allocation of Supplier demand to the same BM Unit in a GSP Group for all Suppliers in the same company group. The purpose of this would be to maximise the advantages of any embedded benefits resulting from Licence Exemptable Generation by reducing the possibility that the generation exceeded the demand.

The P7MG prepared the Modification Proposal P07 Definition Report (Reference 3) for submission to the Panel Meeting of the 31st May 2001. The P7MG, via the Definition Report, recommended that:

- The Modification should be submitted to the Assessment Procedure, for submission of the P07 Modification Proposal Assessment Report to the Panel meeting of the 26th July 2001.
- The Assessment Procedure should assess the implementation of each of two options:
  - The Modification: Option 1 – Allocation to a Single BM Unit; and
  - An Alternative Modification: Option 2 – Allocation to a Trading Unit.
- It be noted that the Alternative Modification Option 2 – Allocation to a Trading Unit, has an impact on the Transmission Company's Charging Methodologies, which would need to be considered.

The Panel approved these recommendations at the meeting of the 31st May 2001, and the Modification proceeded to the Assessment Procedure.

The P7MG met on the 19th June 2001 to define the requirements for each of the Modification options. Each of the Modification options were discussed in detail and a Requirements Specification – 'P007 Requirements Specification for Allocation of Supplier Volumes for more than One Supplier in a GSP Group' (018AAR) was drafted and approved by the P7MG (Reference 4). This was issued for Industry wide consultation and impact assessment on the 28th June 2001, and it is the responses from that impact assessment and the subsequent agreement of the P7MG, at their meeting of the 17th July 2001, that form the basis for this Assessment Report.

The P7 Assessment report was presented at the Panel meeting on 26th July 2001. The Panel directed that the Modification should be submitted back to the Modification Group for further analysis and that the Group should present the Assessment Report to the Panel meeting on 23rd August 2001.

Subsequently there was a further Industry consultation to clarify the sub-options of the Trading Unit proposal. The Industry responses were consistent with the previous consultation and supported the Group's recommendations to allow any group of Suppliers within a GSP Group to combine their BM Units in Trading Group together with any number of CVA registered Licence Exemptable Generator BM Units in the GSP Group.

1.3 Rationale for Recommendations

Both the Modification and the Alternative Modification refer to the realisation of "embedded benefits". The P07 Definition Report (Reference 3) provides more detail on the nature and quantity of such embedded benefits. However, a summary is provided here to provide an indication of the objectives of both the Modification and the Alternative Modification.

Initially, in assessment of the Modification, the main benefits were considered in the context of Supplier Volume Allocation (SVA) registered BM Units and the Group noted that the proposal gave no specific consideration to Central Volume Allocation (CVA) registered Licence Exemptable Generator BM Units. The current BSC allows any number of CVA LEGs to combine in a Trading Unit but with only one Supplier.

To clarify the situation where more than one Supplier could be in the Trading Unit, the Alternative Modification Proposal extends the principles of the original modification to all Licence Exemptable Generators on a non-discriminatory basis. Therefore the Alternative Modifications proposes allowing any grouping of Suppliers and any number of CVA registered Licence Exemptable Generator BM Units within the same GSP Group to be part of the same Trading Unit.

Under the Alternative Modification, embedded benefits would accrue to both SVA Suppliers who have contracts with the actual Licence Exemptable Generators and to CVA Registered Licence Exemptable Generators choosing to form a Trading Unit with Supplier BM units in their GSP Group.

The P7MG considered that both SVA Licence Exemptable Generators and CVA Registered Licence Exemptable Generators would be provided with more choice of parties with whom to contract if the proposed Alternative Modification were approved, thus promoting effective competition within smaller Generators, and the market as a whole.

To summarise, the embedded benefits that both the Modification and Alternative Modification are seeking to maximise are a reduction of charges applicable to traded energy and the additional advantages of increased flexibility in trading. These are identified as:

- Reduction in Balancing Services Use of System (BSUoS) charges;
- Reduction in Transmission Network Use of System (TNUoS) charges;
- Reduction in attributable Transmission Losses;
- Reduction in Balancing and Settlement Code participant (BSCCo) charges;
- Impact on Residual Cash Flow Reallocations (note this is a trade off with BSUoS charges)

In an attempt to quantify the benefits, the P7MG made an estimate of each benefit in £ or pence per MWh. These are provided in the following table:

Table: Estimated Value Achievable for each Embedded Benefit

	Elexon Charges	BSUoS	Residual Cash-flow	Losses	TNUoS	Bid and Offer	Information Imbalance
Estimated Benefit	5p per MWh	£1 per MWh	-£1 per MWh	25p per MWh	£0.20 to £2.80 per MWh depending on location	20p per MWh	£0 per MWh

←-------Trade-off-------→

The P7MG considered and assessed the two options recommended under the Definition Procedure to be taken forward as the Modification and the Alternative Modification and took into consideration the responses from the initial consultation and the industry impact assessment. Therefore the following represents the progression of the P7MG with regards to the decisions taken by the Group and the subsequent recommendations made.

For reference, the Applicable BSC Objectives are set out in paragraph 3 of Condition 7A of the Licence, as follows:

(a) The efficient discharge by the Transmission Company of the obligations imposed under the Transmission Licence;

(b) The efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System;

(c) Promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity;

(d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

The P7MG believed that parties could already access the full embedded benefits outside the BSC. For example, it is possible for Supplier A to agree with Supplier B that Supplier A should supply the customers of Supplier B so that together embedded benefits can be maximised. This would require the Suppliers, in conjunction with their customers to agree to amend the supply contract arrangements so that the customers are re-registered with Supplier A, and the full embedded benefits realised. The benefits would then be shared in some manner between the suppliers and the customers. Suppliers A and B could be Affiliate companies or different companies.

Because it is clear that by reshuffling the contractual arrangements outside the BSC, the full embedded benefits associated with netting off against an exemptable generator may be realised, unless the overall trading arrangements are inefficient in this regard, the fact that they are able to do so must be economically efficient. Were this not the case, then it would be expected that some form of licence prohibition on such activities would exist.

If, instead of forcing parties to re-structure their contractual relationships outside the BSC in order to access the embedded benefits, the BSC rules are changes so as to facilitate their access through the BSC, then, it is argued that the BSC objectives are better met.

First, the objective set down in Condition 7A 3(c) of the Transmission Licence (see above) is better achieved, because it facilitates the access of embedded benefits. This is deemed to be economically efficient because the benefits are capable of being accessed by other routes that are not prohibited.

Second, it better meets the objective set down in Condition 7A 3(d) of the Transmission Licence (see above) because it removes an unnecessary barrier to accessing embedded benefits that are already available.

It is also noted that the P7MG believed that it was inappropriate that the access of embedded benefits was linked to ownership. The general rationale for permitting access to embedded benefits was understood to be based on the fact that embedded generation is deemed to net off local demand, and not to enter onto the transmission system and subsequently re-exit. From an electrical perspective, whether or not this is the case is not a function of whether the demand is supplied by one or more suppliers. Hence, the existing arrangements were judged to be irrational, and both the Modification and the Alternative Modification better meet the objective set down in Condition 7A 3(c) of the Transmission Licence (see above) by removing this irrationality.

Where the original Modification and the Affiliate variant of the Alternative Modification (point 2 in Section 1.1) only go part-way to removing the barriers to accessing embedded benefits (for example by permitting aggregation only with the Supplier BM Unit of an affiliate within the same GSP Group, rather than with the Supplier BM Unit of any supplier in the same GSP Group), the Affiliate variant of the Alternative Modification was still judged to better meet the BSC objectives as set down above, only not to the same extent.

Once it had been ascertained that both the Modification and the Alternative Modification would achieve these benefits, the P7MG undertook the assessment of each of the Modifications with regards to the impact on the legal framework, the central services system functionality and processing, BSC Parties and the implementation costs. The following summarises the findings:

The Modification – Allocation to a Single BM Unit: As discussed above, this was believed to better meet objective (c) and (d). However, the ramifications of implementing this option proved too substantial to recommend that this option be taken forward. The costs and the scope of the impact of implementing the option were deemed to outweigh the benefits obtained from it. Namely, this option required significant changes to the legal framework, central services system functionality and processing and BSC Parties system functionality and processing.

The Alternative Modification - Allocation to a Trading Unit, for All Supplier BM Units and CVA Registered Licence Exemptable BM Units within a GSP Group: This was believed to better meet objectives (c) and (d) as described. The P7MG agreed that the preferred option which most significantly bettered the facilitation of the Applicable BSC Objectives would be to allow the Trading Unit BM Unit allocation for any number of Supplier BM Units within a GSP Group, noting that this will also include any number of CVA Registered Licence Exemptable Generation BM Units within such Trading Unit under the existing provisions of the BSC.

The P7MG noted that the Transmission Company had stated that that the implementation of this Alternative Modification, for both the Affiliate and any Supplier BM Unit variants, would necessitate changes to the Transmission Company's Charging Methodology (as detailed by the Transmission Company in their impact assessment, ANNEX 4). More specifically the Transmission Company believed that the methodology for charging for Transmission Network Use of System (TNUoS) would be affected. However, it was also suggested that it might be theoretically possible for a Trading Unit to exist under the current structure (i.e. prior to any implementation of P07) that would require the Transmission Company to charge in a way that would be necessary after the implementation of P07. Based upon the information provided by the Transmission Company, it was not possible for the P7MG to ascertain whether or not any changes would be needed, nor how much these would be likely to cost in the event that they were required.

The impact of Modification P07 on the Transmission Company's charging methodology was noted by the P7MG, but was judged to be outside the direct scope of the Modification Group. It was therefore believed that it would be appropriate to draw this to the attention of the Panel, whom it is recommended should highlight the issue to the Authority. The Authority may then take the matter into account in making its decision in relation to any recommendation by the Panel.

The P7MG did note that if it were necessary for any changes to be made to the Transmission Company charging methodology, then:

- There may be implications on the implementation timescales of the knock-on implications of the Modification in the charging methodology pending completion of the consultation and implementation of any associated amendments to TNUoS charging; and
- Where the Alternative Modification is implemented prior to the completion of the such Transmission Company consultation, and where it is determined that it is appropriate to change NGC's charging methodology as a consequence, there may be a delay for BSC Parties utilising the process defined in the Alternative Modification, in maximising their full TNUoS embedded benefits, pending completion and implementation of such Transmission Company consultation.

From the point of view of the impact of implementing this Alternative Modification in the BSC, this option requires material, but not significant, changes to the legal framework, but does not impact central services System functionality or processes, and has a significantly lower impact than the Modification, Option 1 on BSC Party system functionality and processing. Therefore the P7MG agreed to recommend that this Alternative Modification be progressed to the Reporting Phase of the Modification Procedure with a recommendation that the Alternative Modification be implemented within four weeks of Authority approval.

In reaching these conclusions the P7MG has taken due account of the views of the:

- Proposer;
- All representations received from interested parties; and
- The P7 Modification Group.